

Message Text

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SUBJECT: APPRECIATION OF THE ECONOMIC POSITION OF NATO AND WARSAW
PACT COUNTRIES FOR THE PERIOD THROUGH 1982

REF: A) USNATO 4181; B) STATE 167800; C) USNATO 4264; D) USNATO 4833

1. QUOTED BELOW (PARA 4) ARE THE INTRODUCTION AND THE SUMMARY
APPRAISAL OF ECONOMIC DIRECTORATE'S DRAFT APPRECIATION OF THE ECONO-
MIC POSITION OF NATO AND WARSAW PACT COUNTRIES FOR THE PERIOD THROUGH
1982 (AC/127-WP/407). THE DRAFT IS BASED ON MATERIAL GENERALLY AVAIL-
ABLE TO THE DIRECTORATE FROM OECD, EEC, IMF AND PRESS REPORTS. SINCE
THE FINAL ECONOMIC APPRECIATION WILL HELP SET THE ECONOMIC BASE FOR
MINISTERIAL GUIDANCE FOR NATO FORCE PLANNING, THE ECONOMIC DIRECTORATE

HOPES TO HAVE AN AGREED REPORT BY OCTOBER 1. IN VIEW OF THE CONSTRICT-

ED TIME FRAME, THE ECONOMIC COMMITTEE WILL EXCHANGE PRELIMINARY VIEWS
ON THE DRAFT APPRECIATION AT ITS SEPTEMBER 12 MEETING (REF D).

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2. IN THE MISSION'S VIEW, THE APPRECIATION IS IN GENERAL A WELL
PREPARED DOCUMENT, PARTICULARLY CONSIDERING THE OBVIOUS DIFFICULTIES
OF MAKING PROJECTIONS OF THE LONG-TERM
ECONOMIC OUTLOOK. OUR MAJOR RESERVATION REGARDING

CONCLUSIONS REACHED IN THE REPORT RELATES TO THE STATEMENT THAT NORTH AMERICAN MEMBER COUNTRIES WILL RETAIN THE OPTION OF INCREASING THEIR DEFENSE EFFORT AT A CONSIDERABLY HIGHER RATE THAN CURRENTLY ANTICIPATED, WHILE FOR NATO EUROPE THE ONLY OPTION IS TO MAINTAIN OR SLIGHTLY INCREASE DEFENSE EXPENDITURES IN A SITUATION OF STAGNATING ECONOMIC GROWTH (PARA 9 OF SUMMARY APPRAISAL). THE STATEMENT IS BASED ON ESTIMATES IN THE BODY OF THE DRAFT THAT THE MOST THE EUROPEAN COUNTRIES CAN HOPE FOR OVER THE PERIOD TO 1978 IS AVERAGE ANNUAL GROWTH RATE OF 2 TO 3 PERCENT, WHILE IN NORTH AMERICAN THERE ARE PROPOSECTS FOR A GROWTH RATE IN THE ORDER OF 4 PERCENT. SOME ALLIES COULD INTERPRET SUCH PROJECTIONS, WHICH ARE HIGHLY CONJECTURAL AND MAY WELL BE OVERLY OPTIMISTIC FOR THE U.S.,

AS A JUSTIFICATION FOR RELAXING THEIR DEFENSE EFFORTS AND EXPECTING NORTH AMERICA TO TAKE UP THE SLACK. CONSEQUENTLY, US ECONAD WILL INSIST THAT SUCH A STARK CONTRAST BETWEEN EUROPE AND NORTH AMERICA SHOULD NOT BE MADE ON THE BASIS OF DUBIOUS PROJECTIONS.

3. ACTION REQUESTED. ANY GUIDANCE APPROPRIATE FOR INITIAL EXCHANGE OF VIEWS ON DRAFT AT SEPTEMBER 12 MEETING.

4. QTE.

APPRECIATION OF THE ECONOMIC POSITION OF NATO
AND WARSAW PACT COUNTRIES FOR THE PERIOD
THROUGH 1980

INTRODUCTION

THE FIRST ECONOMIC APPRECIATION PREPARED IN 1972-73 COVERING THE PERIOD UP TO 1980, WHILE STILL VALID AS REGARDS THE EVALUATION OF THE MAIN ECONOMIC FACTORS INFLUENCING DEFENCE, WAS BASED ON THE ASSUMPTION THAT NO RADICAL CHANGES WOULD TAKE PLACE IN WORLD POLITICAL AND ECONOMIC RELATIONSHIPS. FOLLOWING THE STRONG WORLDWIDE INFLATIONARY DEVELOPMENT AND THE SERIOUS DETERIORATION OF THE BALANCE OF PAYMENTS OF MOST NATO COUNTRIES AS A CONSEQUENCE OF THE ENERGY CRISIS, THE ECONOMIC OUTLOOK FOR LIMITED OFFICIAL USE

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THE PERIOD UP TO 1982 HAS WORSENED DRASTICALLY. FOR THE WARSAW PACT COUNTRIES AS A WHOLE THE RECENT INTERNATIONAL ECONOMIC DEVELOPMENTS HAVE, IF ANYTHING, MADE THE OUTLOOK SLIGHTLY MORE FAVOURABLE THAN THAT DESCRIBED IN THE PREVIOUS APPRECIATION.

2. THE LONGER TERM EFFECTS OF THE FUNDAMENTAL ECONOMIC CHANGES WHICH HAVE TAKEN PLACE SINCE 1973 ARE VERY DIFFICULT TO FORESEE AT THIS EARLY STAGE, PARTICULARLY FOR THE NATO MEMBER COUNTRIES, AND ONLY TENTATIVE FORECASTS COULD BE MADE. THE FIRST PART OF THE APPRECIATION, WHICH COVERS ECONOMIC DEVELOPMENTS IN NATO COUNTRIES AND THE ECONOMIC BASES FOR DEFENCE IN THESE COUNTRIES, HAVE BEEN BASED ON CERTAIN ASSUMPTIONS. IT HAS BEEN

ASSUMED THAT THE CURRENT INFLATIONARY PROBLEM IS BROUGHT UNDER CONTROL, THAT THE RECYCLING OF THE OIL EXPORTING COUNTRIES' INCOMES IN THE INTERNATIONAL MONETARY SYSTEM IS SUCCESSFULLY ARRANGED AND THAT THE RESTRUCTURING AND READJUSTMENT PROCESSES DEVELOP SMOOTHLY IN WESTERN ECONOMIES. A RELATIVELY FAVOURABLE ECONOMIC OUTLOOK CAN BE EXPECTED DURING THE PERIOD UNDER CONSIDERATION IF THESE TASKS ARE IMPLEMENTED. IF, ON THE OTHER HAND, ONE OR MORE OF THEM ARE NOT MET THIS COULD IRRETRIEVABLY BRING ABOUT A WORLDWIDE ECONOMIC RECESSION OF A MAGNITUDE UNPRECEDENTED IN THE POST-WAR PERIOD.

3. THE SECOND PART OF THE REPORT COVERS THE ECONOMIC DEVELOPMENT IN WARSAW PACT COUNTRIES AND THE DEVELOPMENT OF THE ABILITY OF THESE ECONOMIES TO SUPPORT THE DEFENCE EFFORT. ON THE WHOLE IT SEEMS THAT EXTERNAL FACTORS SHOULD ONLY marginally AFFECT THE ECONOMIC DEVELOPMENT OF THESE COUNTRIES UP TO 1982 AND THE EVALUATION GIVEN FOR WARSAW PACT COUNTRIES IN THE 1972-73 APPRECIATION IS THEREFORE STILL VALID.

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SUMMARY APPRAISAL

4. THE YEAR 1973 WAS A TURNING POINT FOR THE ECONOMIC DEVELOPMENT OF MEMBER COUNTRIES. UP TO THAT YEAR IT SEEMED THAT THE GROWTH PERFORMANCE OF THE 1960S MIGHT BE REPEATED IN THE 1970S AND THAT THE STRENGTH OF THE ECONOMIES AND THE POTENTIAL MILITARY CAPABILITIES OF BOTH NATO AND WARSAW PACT COUNTRIES COULD THUS BE INCREASED SUBSTANTIALLY OVER THE PERIOD UNDER REVIEW. THE STRONG INFLATIONARY DEVELOPMENT FROM 1972-73

AND THE FORESEEABLE BALANCE OF PAYMENTS PROBLEMS OF NATO COUNTRIES CREATED BY THE STEEPLY RISING ENERGY PRICES DURING THE LAST QUARTER OF 1973 HAVE COMPLETELY ALTERED THE DROWTH OUTLOOK FOR THE 1970S. THIS FACTOR AND INCREASINGLY DIFFICULT POLITICAL AND SOCIAL PROBLEMS HAVE LED TOMORE FRAGILE ECONOMIC INTER-RELATIONSHIPS THAT COULD EASILY BE REDUCED TO DISORDER BY AN UNFORESEEN TRAIN OF EVENTS. IN SUCH CIRCUMSTANCES THE POSSIBILITY OF RECESSION TAKING A GRIP AND ASSUMING WORLDWIDE PROPORTIONS CANNOT BE RULED OUT.

5. A CLEARCUT DISTINCTION MUST BE MADE BETWEEN THE
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DIFFICULT PERIOD UP TO 1978 AND THE PERIOD AFTER 1978 WHEN THE SITUATION SHOULD IMPROVE DUE TO THE INCREASED FLOW OF OIL AND GAS IN THE NATO AREA AND THE GRADUAL ADJUSTMENT OF MEMBER COUNTRIES' ECONOMIES TO THE NEW CONDITIONS. EVEN SUPPOSING THAT NATO GOVERNMENTS CAN COPE WITH THE MANY DIFFICULT ECONOMIC PROBLEMS MENTIONED ABOVE, IN THE PRESENT FAR FROM CLEAR SITUATION THE OUTLOOK POINTS DECISIVELY TO SLUGGISH GROWTH. UNDER THE BEST CONDITIONS IT WILL TAKE TIME FOR CORRECTIVE MEASURES TO TAKE EFFECT AND THEREFORE THE MOST THAT CAN BE HOPED FOR OVER THE PEROD TO 1978 IS AVERAGE GROWTH RATES OF THE ORDER OF 2-3 PER CENT FOR MOST NATO EUROPEAN COUNTRIES. ON THE OTHER HAND IN NORTH AMERICA WHERE THE POSITION IS BASICALLY STRONGER, THE GROWTH RATE COULD BE OF THE ORDER OF 4 PER CENT. UP TO 1982 THE GROWTH RATE IS UNLIKELY TO CHANGE MUCH IN NORTH AMERICA WHILE AN IMPROVEMENT COULD BE EXPECTED IN EUROPE.

6. THE EVENTS THAT HAVE HIT NATO COUNTRIES ARE LIKELY TO HAVE LITTLE EFFECT OR EVEN A POSITIVE ONE ON THE WARSAW PACT COUNTRIES. ECONOMIC GROWTH COULD AVERAGE SOME 5 PER CENT PER YEAR OVER THE PERIOD UP TO 1982. IF IMPLEMENTED THIS WOULD CONTRIBUTE TOWARDS REDUCING THE CURRENT ECONOMIC SUPERIORITY OF NATO COUNTRIES AS A WHOLE AND TO IMPROVING THE RELATIVE ECONOMIC POSITION OF WARSAW PACT COUNTRIES.

7. WHILE THEREFORE THE DEFENCE CAPABILITY OF WARSAW PACT COUNTRIES IS LIKELY TO INCREASE RAPADLY OVER THE PERIOD UNDER REVIEW THE ABILITY OF MOST NATO COUNTRIES TO SUPPORT THEIR DEFENCE EFFORT COULD AT BEST INCREASE ONLY SLOWLY.

8. THE SOVIET UNION COULD INCREASE CONSIDERABLY IN REAL TERMS THE AMOUNT OF RESOURCES GOING TO DEFENCE WITHOUT INCREASING THE RELATIVE BURDEN ON THE ECONOMY, I.E. WITHOUT INCREASING THE SHARE OF GNP GOING TO DEFENCE. ON THE ASSUMPTIONS MADE ABOVE THE REAL INCREASE OF DEFENCE EXPENDITURE COULD RISE TO 5 PER CENT YEARLY INSTEAD OF 3 PER CENT AS IN RECENT YEARS.
AS A RESULT THE SOVIET UNION COULD EASILY OUTSTRIP THE NATO EFFORT WITHOUT PLACING AN INTOLERABLE BURDEN ON THE ECONOMY. THEY COULD ALSO CHOOSE TO MAINTAIN THE CURRENT SHARE

WHICH CORRESPONDS TO THAT OF THE NATO AVERAGE, AND AT THE SAME TIME
DIVERT CONSIDRABLE ADDITIONAL ECONOMIC RESOURCES TO THE CIVILIAN
SECTOR. THESE OPTIONS CREAE A CONSIDERABLE FLEXIBILITY FOR THE
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SOVIET LEADERS, WHO CAN EASILY ADJUST THEIR POLICIES TO THE
PREVAILING POLITICAL AND ECONOMIC SITUATION, BOTH INTERNAL AND
EXTERNAL.

9. AS REGARDS NATO AS A WHOLE SOME FLEXIBILITY EXISITS BUT
TO A LESSER DEGREE. THE NORTH AMERICAN MEMBER COUNTRIES RETAIN,
HOWEVER, A SET OF OPTIONS. THEY CAN IF NECESSARY INCREASE
THEIR DEFENCE EFFORTS AT A CONSIDERABLY HIGHER RATE THAN CURRENTLY
ANTICIPATED. FOR NATO EUROPE THE ONLY OPTION OVER THE NEXT FEW
YEARS SEEMS TO BE TO MAINTAIN OR EVEN INCREASE THE DEFENCE EFFORT
IN A SITUATION OF STAGNATING ECONOMIC GROWTH. OTHERWISE
EUROPEAN COUNTRIES MIGHT BE FACED WITH A SERIOUS DECLINE OF
THEIR DEFENCE CAPABILITY. HOWEVER TAFTER 1978 THE SITUATION IN
EUROPEAN MEMBER COUNTRIES SHOULD IMPROVE SOMEWHAT.

10. THE ECONOMIC PROBLEMS FACING MEMBER COUNTRIES VARY
CONSIDERABLY. IN COUNTRIES WITH LOW OR ZERO GROWTH AND SERIOUS
PAYMENTS PROBLEMS, WHICH FAIL TO COPE WITH THE RESTRUCTURING
PROBLEMS, CONDITIONS COULD BE CREATED THAT WOULD UNDERMINE THEIR
ECONOMIC AND POLITICAL STABILITY. FOR THE HARDEST HIT COUNTRIES
IMPLEMENTATION OF THE FORCE PROPOSALS MIGHT THEREFORE RAISE
UNACCEPTABLE ECONOMIC AND POLITICAL PROBLEMS. OTHER MEMBER COUNTRIES
WHICH ARE SUFFICIENTLY WELL PLACED MIGHT, HOWEVER, IN THE YEARS
AHEAD DO RELATIVELY MORE TO COMPENSATE EVENTUAL SHORTFALLS IF THEY
WISH TO AVOID SERIOUSLY TO REDUCE THE DEFENCE CAPABILITY OF THE
ALLIANCE.

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